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No. 94-500

In the Supreme Court of the United States

OCTOBER TERM, 1994

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ERICH E. AND HELEN B. SCHLEIER

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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A. Back pay and liquidated damages awarded under the ADEA do not represent damages received on account of personal injuries

1. The question presented in this case is whether back pay and liquidated damages received in litigation under the Age Discrimination in Employment Act (ADEA) are excludable from gross income under Section 104(a)(2) of the Internal Revenue Code. Section 104(a)(2) provides an exclusion from gross income for "any damages received * * * on account of personal injuries or sickness." The accompanying Treasury regulation states that the term "damages received" means "an amount received * * * through prosecution of a legal suit or action based upon tort or tort type rights, or

through a settlement agreement entered into in lieu of such prosecution." 26 C.F.R. 1.104-1(c). Under the statute, as amplified by the regulation, a recovery may be excluded from gross income only when it both (i) was received through prosecution or settlement of an "action based upon tort or tort type rights" (*ibid.*) and (ii) was received "on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)). As an exclusion from gross income, Section 104(a)(2) "is to be construed narrowly" (*United States* v. *Centennial Savings Bank*, 499 U.S. 573, 583 (1991)).[1] See also *United States* v. *Burke*, 112 S. Ct. 1867, 1876 (1992) (Scalia, J., concurring); *id.* at 1878 (Souter, J., concurring).

In *Burke*, the Court concluded that a remedial structure that compensates for economic loss but does not compensate for personal components of injury such as pain and suffering does not yield "damages * * * on account of personal injuries" within the meaning of the statute and the regulation. A breach of contract, for example, may well be regarded by the offended party as injuring him "personally." In that loose sense, a breach of contract could be said to inflict "personal injuries."[2]

[1] Respondent's contention that Section 104(a)(2) should be interpreted "compassionately" (Resp. Br. 18-24) is incorrect. As an exclusion from income, Section 104(a)(2) "[i]s to be construed narrowly" (*United States* v. *Centennial Savings Bank*, 499 U.S. at 583). In concluding that back pay received by victims of sex discrimination under the remedial structure of the pre-1991 version of Title VII is not excluded from income under Section 104(a)(2), the Court emphasized in *Burke* that "[t]he fact that employment discrimination causes harm to individuals does not automatically imply * * * that there exists a tort-like 'personal injury' for purposes of federal income tax law." 112 S. Ct. at 1873.

[2] Similarly, a corporation or individual may recover damages under a "tort or tort type" cause of action—such as claims for injuries to property, fraud and trade libel—that would *not* qualify for an exclusion from income under the statute because they involve injuries to property or other economic interests rather than injuries to the person. The regulatory definition of "damages received" (in 26 C.F.R. 1.104-1(c)) cannot be understood in isolation from the further statutory requirement that such damages be received "on account of personal injuries or sickness" (26 U.S.C. 104(a)(2)).

Congress, however, obviously did not employ the term "personal injuries" in that loose manner. Instead, as the Court reasoned in *Burke*, as employed in Section 104(a)(2), the term properly refers to a recovery under a tort-like scheme of relief that compensates the individual for the personal elements of his injury, "such as pain and suffering, emotional distress, [and] harm to reputation." 112 S. Ct. at 1873. The Commissioner, whose interpretation is entitled to "controlling weight" (*Bowles* v. *Seminole Rock & Sand Co.*, 325 U.S. 410, 414 (1945)), has expressed the same understanding of the regulation.[3] See Rev. Rul. 93-88, 1993-2 C.B. 61.

In the present case, the ADEA makes no provision for compensation for pain and suffering, emotional distress or any other personal element of injury. Under this Court's holding in *Burke*, and under the Commissioner's interpretation of her own regulation, the recovery at issue in this case is therefore not excluded from income under Section 104(a)(2).

[3] "In construing regulations, the Court normally defers to the agency's interpretation." *North Haven Board of Education* v. *Bell*, 456 U.S. 512, 538 n.29 (1982). See also *Ford Motor Credit* v. *Milhollin*, 444 U.S. 555, 565 (1980) (agency interpretation of its own regulation upheld "[u]nless demonstrably irrational"). The Court has noted the particular need for deference to Treasury regulations to ensure that in "'this area of limitless factual variations' * * * like cases will be treated alike." *National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 477 (1979), quoting *United States* v. *Correll*, 389 U.S. 299, 307 (1967).

2. a. It is obvious that, if only backwages were available under the ADEA, this suit would fall within the precise holding of *Burke*. Respondent, of course, contends that this case differs from *Burke* because the ADEA provides not only backwages but also liquidated damages (in an amount equal to the backpay award) for "willful violations" of the ADEA. Even though personal components of loss such as pain and suffering and emotional distress are not compensable (or even admissible) in an ADEA suit, respondent claims that an award of liquidated damages under the ADEA (when available) somehow indirectly effects compensation for these "difficult to prove" personal losses (Resp. Br. 15, 24-31).

In making that contention, respondent persists in relying (Resp. Br. 15, 24-31) on the inapposite decisions of *Brooklyn Savings Bank* v. *O'Neil*, 324 U.S. 697, 707 (1945), and *Overnight Motor Transportation Co.* v. *Missel*, 316 U.S. 572, 583, 584 (1942), which held that liquidated damages under the different text of the since-amended provisions of the Fair Labor Standards Act of 1938 represented compensation for "damages too obscure and difficult of proof" (Pet. App. 29a). Refusing to come to grips with the obvious differences in the language of the provisions relating to liquidated damages under the pre-1947 version of the FLSA and under the ADEA as enacted in 1967, respondent claims (Resp. Br. 26-27) that the decisions in *Brooklyn Savings* and *Overnight Motor* are applicable here because the ADEA "incorporated" the FLSA remedies.

That contention is well wide of the mark. There are manifest, important differences between the pre-1947 FLSA liquidated damages provisions involved in *Brooklyn Savings* and *Overnight Motor* and the provisions enacted by Congress in the ADEA in 1967. As

we explain in our opening brief (Pet. Br. 20-25), the description in *Brooklyn Savings* and *Overnight Motor* of the compensatory nature of the *mandatory* liquidated damages provision under the pre-1947 version of the FLSA is simply inapplicable to the different provisions of the ADEA, under which liquidated damages are available only for "willful violations" of that Act.[4] The Court noted that very distinction in *Trans World Airlines, Inc.* v. *Thurston*, 469 U.S. 111 (1985), in concluding that liquidated damages for "willful violations" of the ADEA are not compensatory but are "punitive in nature." *Id.* at 125.[5] Respondent simply fails to acknowledge that the very decisions on which he relies were distinguished by this Court in *Thurston* in explaining the significant differences between the

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[4] Respondent mischaracterizes our discussion of the 1947 amendment to the FLSA, which allowed employers to defend against an award of liquidated damages based on a showing of good faith. Contrary to respondent's contention (Resp. Br. 27), our position that ADEA liquidated damages are punitive rather than compensatory is not based on the 1947 amendment to the FLSA. In fact, we explicitly stated that "[w]hen the ADEA was enacted in 1967, and 'modeled in part' on the then-existing provisions of the FLSA, * * * *the availability of liquidated damages was further expressly limited to those situations where the employer had 'willfully' violated the ADEA*" (Pet. Br. 22-23 (emphasis added)). We further noted that it was in this context that the Court correctly concluded in *Trans World Airlines, Inc.* v. *Thurston*, that ADEA liquidated damages are "punitive in nature" (Pet. Br. 23).

[5] See also *Reichman* v. *Bonsignore, Brignati & Mazzola P.C.*, 818 F.2d 278, 282 (2d Cir. 1987) (holding that an ADEA litigant may recover both liquidated damages and prejudgment interest on the back pay award because *Thurston* held "that liquidated damages under the ADEA are punitive in nature"); *Lindsey* v. *American Cast Iron Pipe Co.*, 810 F.2d 1094, 1102 & n.7 (11th Cir. 1987) (same).

remedial scheme of the ADEA and that of the pre-1947 version of the FLSA. See *id.* at 128 n.22.

In *Thurston*, the Court explained that the 1967 legislative history of the ADEA, as well as the text of that Act, revealed that "Congress intended for liquidated damages to be punitive in nature." 469 U.S. at 125. In particular, the liquidated damages remedy for "willful violations" of the ADEA was adopted as a substitute for the *criminal* provisions of the FLSA (29 U.S.C. 216(a)) that provide penalties for "willful violations" of that statute. 469 U.S. at 125-126.[6] As the Court explained in *Thurston* (*id.* at 125):

> The legislative history of the ADEA indicates that Congress intended for liquidated damages to be punitive in nature. The original bill proposed by the administration incorporated §16(a) of the FLSA, which imposes criminal liability for a willful violation. * * * Senator Javits found "certain serious defects" in the administration bill. He stated that "difficult problems of proof . . . would arise under a criminal provision," and that the employer's invocation of the Fifth Amendment might impede investigation, conciliation, and enforcement. * * * Therefore, he proposed that "the [FLSA's] criminal penalty in cases of willful violation . . . [be] eliminated and a double damage liability substituted." * * * Senator Javits argued that his proposed amendment would "furnish an effective deterrent to willful violations [of the ADEA] * * *."

[6] See also *Smith* v. *Department of Human Services*, 876 F.2d 832, 836 (10th Cir. 1989); *Maleszewski* v. *United States*, 827 F. Supp. 1553, 1556 (N.D. Fla. 1993) ("The ADEA included the liquidated damages provision in lieu of the criminal penalty for willful violations of the Fair Labor Standards Act.").

Liquidated damages under the ADEA are not compensatory in form or function. They serve as a substitute for criminal penalties and were enacted to provide punishment and deterrence for "willful violations" of that Act.[7] *Ibid.*

Respondent contends that it is an "oversimplistic dichotomy" (Resp. Br. 30) to separate compensatory from punitive damages. But this Court has long recognized that "punitive damages * * * are not compensation for injury. Instead, they are private fines levied by civil juries to punish reprehensible conduct and to deter its future occurrence." *Gertz* v. *Robert Welch, Inc.*, 418 U.S. 323, 350 (1974). Similarly, in *Molzof* v. *United States*, 112 S. Ct. 711 (1992), the Court noted that "the common law recognizes that damages intended to compensate the plaintiff are different in kind from 'punitive damages'" and that "[t]he term 'punitive damages' * * * embodies an element of the defendant's

[7] Respondent errs in relying (Resp. Br. 16 n.14) on the legislative history of the 1978 amendment to the jury trial provisions of the ADEA. A committee report issued in connection with that amendment referred to the *Overnight Motor* decision as evidencing a "compensatory" nature for liquidated damages (Resp. Br. 16 n.14). When this Court reviewed the history of the 1978 amendment in *Thurston* (see 469 U.S. at 123-124), the Court gave no weight to the committee report's erroneous referrences to *Overnight Motor*. Instead, in determining that ADEA liquidated damages are punitive in nature, rather than compensatory, the Court distinguished the *Brooklyn Savings* and *Overnight Motor* decisions to which the 1978 legislative history referred. See *id.* at 128 n.22. As evidenced by this Court's decision in *Thurston*, respondent's invocation of the 1978 committee report provides a perfect illustration of the fact that subsequent legislative history provides a "hazardous basis" for inferrring the intent of the Congress that enacted the earlier legislation (*United States* v. *Texas*, 113 S. Ct. 1631, 1635 & n.4 (1993)).

conduct that must be proved before such damages are awarded." *Id.* at 716.

If Congress had intended to compensate age discrimination plaintiffs for personal injuries such as pain and suffering and emotional distress, it would not have done so through an award of "liquidated damages" that is predicated on willful misconduct and measured solely by the employee's lost wages. Instead, Congress would have explicitly provided compensatory damages for intangible elements of personal injury as it did, for example, in the Civil Rights Act of 1991, Pub. L. No. 102-166, § 1977(b)(3), 105 Stat. 1073.

b. Even if liquidated damages under the ADEA were thought to be in some fashion "compensatory"—rather than "punitive in nature" (469 U.S. at 125)—that does not mean that such damages compensate for "personal injuries." For example, damages for breach of contract or for trespass of chattels are "compensatory" but they do not compensate for "personal injuries" and are thus not within the exclusion from income of Section 104(a)(2). Whether liquidated damages under the ADEA are thought of as "compensation" or as "punishment," they plainly do not represent compensation for the inadmissible personal components of the plaintiff's injury—such as pain and suffering—and therefore are not excludable under Section 104(a)(2). An award of ADEA liquidated damages is simply a "double damages" penalty designed to punish and deter willful violations of the Act.

Under the analysis applied by the Internal Revenue Service in interpreting the regulation, recoveries of backwages and liquidated damages under the ADEA do

not come within the statutory exclusion.[8] See Rev. Rul. 93-88, 1993-2 C.B. 61. Because the agency's interpretation does not conflict with the plain language of the statute or the regulation, it is entitled to "controlling weight" (*Thomas Jefferson University* v. *Shalala*, 114 S. Ct. 2381, 2386 (1994)).[9] Cf. *United States* v. *Burke*, 112

[8] Respondent struggles to find an inconsistency in the Service's position by citing (Resp. Br. 25-26) Rev. Rul. 69-581, 1969-2 C.B. 26, which permits *employers* a deduction (as a business expense) for payments of backwages and liquidated damages under *the FLSA*. The question addressed in that Ruling was whether backwages and liquidated damages paid by employers represented non-deductible fines and penalties. Relying on the pre-1946 decisions of this Court in *Overnight Motor* and *Brooklyn Savings*, the Service concluded that FLSA liquidated damages were deductible by employers as "compensation for delay" in payments of backwages. *Ibid.* As the Court concluded in *Thurston*, however, the pre-1946 FLSA cases are inapplicable to the different language of the ADEA. 469 U.S. at 128 n.22. The present case, of course, involves the ADEA, not the FLSA. Moreover, notwithstanding respondent's incorrect contention that the Commissioner's position under the FLSA is "newly adopted for this Court" (Resp. Br. 25), the Service has long ruled that FLSA recoveries of backpay and liquidated damages are not excluded from income under Section 104(a)(2). See Rev. Rul. 72-268, 1972-1 C.B. 313 ("such amounts are income to the employees and must be included in their Federal income tax returns").

Respondent also quotes a portion of one sentence of our opening brief out of context as a basis for alleging (Resp. Br. 31) that the government has not maintained a consistent view on ADEA liquidated damages. It is clear, however, that the government has consistently maintained that recoveries of damages under remedial schemes like that of the ADEA are not excluded from income under Section 104(a)(2). See, *e.g.*, Pet. Br. 25-35; Rev. Rul. 93-88, *supra*; Rev. Rul. 72-268, *supra*.

[9] See, *e.g.*, *Rex Trailer Co.* v. *United States*, 350 U.S. 148, 151 (1956) (noting that liquidated damages are a well-known remedy for breach of contract); *Kolb* v. *Goldring, Inc.*, 694 F.2d 869, 871-872 (1st Cir. 1982) (noting that the ADEA provides a remedy

S. Ct. at 1874 n.13 (noting that the Court's decision conformed to Rev. Rul. 72-341, 1972-2 C.B. 32).

3. a. A defining characteristic of dignitary tort actions under the common law is that damages for intangible elements of personal injury are awarded without regard to whether the victim suffered economic loss (D. Dobbs, *Law of Remedies* 623 (2d ed. 1993)):[10]

> [D]ignitary harms may cause economic harm as well as affront to personality. If so, economic damages may be recovered. However, in a great many of the cases, the only harm is the affront to the plaintiff's dignity * * *, the damage to his self-image, and the resulting mental distress. It does not follow that recovery is limited to nominal damages, however, even if the extent of emotional distress is not proved. On the contrary, the traditional rule for "trespassory" cases like assaults and batteries, was that "general damages" or "presumed damages" of a substantial amount can be recovered merely upon showing that the tort was committed at all.

By contrast, *all* damages awarded under the ADEA are contingent upon proof of economic loss. It is thus incorrect to suggest that the limited statutory remedies of the ADEA represent a dignitary "tort" within the meaning of the regulation. The Commissioner's contrary interpretation of her own regulation should, in any event, be dispositive on this point. See note 3, *supra*.

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similar to a suit "for back wages for breach of contract," that "[p]ain and suffering form no part of the damages" and that common law "[p]unitive damages are not allowed").

[10] The Court cited this treatise with approval in *United States* v. *Burke*, 112 S. Ct. at 1871-1872.

Respondent's further contention (Resp. Br. 17) that ADEA liquidated damages are similar to common law "presumed damages" is flawed in several respects. Presumed damages under the common law were not contingent upon "willful" misconduct by the defendant. Instead, when available, "the traditional rule * * * was that 'general damages' or 'presumed damages' of a substantial amount can be recovered merely upon showing that the tort was committed at all." D. Dobbs, *supra*, at 623. Second, presumed damages at common law were awarded irrespective of economic loss. See *Carey* v. *Piphus*, 435 U.S. 247, 262 (1978) ("the doctrine of presumed damages in the common law of defamation *per se* 'is an oddity of tort law, for it allows recovery of purportedly compensatory damages without evidence of actual loss' ") (quoting *Gertz* v. *Robert Welch, Inc.*, 418 U.S. at 349). By contrast, liquidated damages under the ADEA are available *only* for "willful violations" of the Act and, when available, are measured *solely* by the amount of the backwages award. ADEA liquidated damages thus have neither of the distinguishing characteristics of "presumed damages."

b. Respondent errs in suggesting that the availability of a jury trial under the ADEA evidences a "tort type" remedial scheme (Resp. Br. 12-14). As explained in our opening brief (Pet. Br. 21 n.11), while the lack of a right to a jury trial may indicate a particular remedy is not "tort type" in nature, the availability of a jury trial cannot establish that the right is "tort type." Jury trials are as available in contract cases as they are in tort cases. Moreover, if the Court had considered the availability of a jury trial to be dispositive of the issue before it in *Burke*, the Court could simply have resolved the open question whether jury trials were available under the pre-1991 version of Title VII (see *Lytle* v.

Household Manufacturing, Inc., 494 U.S. 545, 549 n.1 (1990)) and based its decision on that result. Respondent, in any event, ultimately acknowledges (Resp. Br. 12-13) that the availability of a jury trial is not determinative for Section 104(a)(2) purposes.

4. a. Respondent states (Resp. Br. 11) that "*Burke* cited with approval" the Third Circuit's decision in *Rickel* v. *Commissioner*, 900 F.2d 655 (1990), which held that back pay awards under the ADEA are excludable under Section 104(a)(2). The Court cited *Rickel*, however, for the limited proposition that the Service and the courts had long recognized that the term "personal injuries" in Section 104(a)(2) encompasses nonphysical injuries. See 112 S. Ct. at 1871 n.6; Pet. Br. 12-13 n.3. The Court did so in response to Justice Scalia's concurring opinion, which concluded that Section 104(a)(2) applies only to damages to an individual's physical or mental health and does not encompass dignitary torts. See 112 S. Ct. at 1874-1876. Respondent is incorrect in implying that the Court endorsed *Rickel* for the further proposition that ADEA recoveries are excludable under Section 104(a)(2).

Far from agreeing with *Rickel* on the ultimate merits, the analysis applied by the Court in *Burke* repudiated the reasoning of that decision. In *Rickel*, the Third Circuit concluded that back pay received under federal antidiscrimination statutes is excludable from gross income under Section 104(a)(2) because those statutes redress "personal injuries." The court of appeals reasoned that the ADEA represents a tort-type remedial scheme because (i) an ADEA suit alleges a violation of a duty that arises by operation of a statute and not by virtue of a contract and (ii) statutes addressing discrimination in the workplace had been characterized by other courts as involving personal injury. 900 F.2d at

662-663. That is the same analytical approach that the Sixth Circuit applied in *Burke*, 929 F.2d 1119, 1122-1123 (1991), which this Court rejected in holding that back pay received under the pre-1991 version of Title VII is *not* excludable from income under Section 104(a)(2). See *Downey* v. *Commissioner*, 33 F.3d 836, 838 (7th Cir. 1994), petition for cert. pending, No. 94-999; *Schmitz* v. *Commissioner*, 34 F.3d 790, 792 (9th Cir. 1994).[11]

b. Respondent's discussion of the history of Section 104(a)(2) (Resp. Br. 20-21 n.18) mischaracterizes our opening brief and misdescribes that history. Contrary to respondent's assertion, our opening brief did not suggest that, between 1920 and 1972, the Service took the position that damages for intangible injuries were subject to tax. Instead, we correctly stated (Pet. Br. 12 n.3) that, during that period, the Service interpreted Section 104(a)(2) as encompassing only damages recovered in connection with physical injuries. See Sol. Mem. 1384, 2 C.B. 71 (1920). Contrary to respondent's assertion, Sol. Op. 132, I-1 C.B. 92, 93 (1922), did not reject that interpretation of the statute. Instead, that opinion explicitly stated that "Solicitor's Memorandum 1384 correctly held that the exemption contained in section 213(b)(6) of the Revenue Act of 1918 does *not* include damages for alienation of affections" (emphasis added). That opinion based its conclusion that such recoveries were not subject to tax on the different theory that they represented a "return

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[11] Two other pre-*Burke* decisions also adopted the reasoning of *Rickel* in concluding that ADEA recoveries were excluded from income under Section 104(a)(2). See *Pistillo* v. *Commissioner*, 912 F.2d 145 (6th Cir. 1990); *Redfield* v. *Insurance Company of North America*, 940 F.2d 542 (9th Cir. 1990). Respondent errs in suggesting (Resp. Br. 10) that the analysis of those decisions remains relevant after their reasoning was repudiated by this Court in *Burke*.

of capital" that did not constitute "income" under this Court's decision in *Eisner* v. *Macomber*, 252 U.S. 189 (1920).

Prior to 1972, the Service's conclusion that damages for intangible injuries were not taxable was thus predicated on a narrow view of income, not on the language of Section 104(a)(2). That same rationale was adopted by the Board of Tax Appeals in *Hawkins* v. *Commissioner*, 6 B.T.A. 1023 (1927), acq., 7-1 C.B. 14 (1928), where the court held that libel damages did not constitute income. Although this Court in *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955), subsequently rejected the narrow definition of "income" reflected in these authorities, the Service's rulings (Rev. Rul. 58-418, 1958-2 C.B. 18, 19) continued to reflect the older view that compensatory damages received in a libel action did not constitute "income" within the meaning of Section 61 of the Internal Revenue Code. It was not until 1972, when the Service acquiesced in *Seay* v. *Commissioner*, 58 T.C. 32 (1972), acq., 1972-2 C.B. 3, that the Service accepted the rationale that damages for nonphysical injuries represent "income" that is excluded from tax under Section 104(a)(2). See also Pet. Br. 30-32; Kahn, *Compensatory and Punitive Damages for a Personal Injury: To Tax or Not to Tax?*, 2 Fla. Tax Rev. 327, 330-332 (1995).

With respect to both physical and non-physical injuries, only damages awarded under a remedial scheme that compensates for the personal components of loss—such as pain and suffering—qualify as damages "on account of personal injury" under Section 104(a)(2). See Rev. Rul. 93-88, *supra*.

B. Liquidated damages under the ADEA are not excluded from income under Section 104(a)(2) for the additional reason that they are awarded "on account of" the defendant's willful misconduct rather than "on account of" the taxpayer's personal injuries

In our opening brief (Pet. Br. 25-35), we explain that ADEA liquidated damages are not excludable from income for the additional independent reason that such damages are awarded "on account of" the employer's willful misconduct and not "on account of" the employee's personal injuries. The text, structure, title and legislative history of the statute indicate that Section 104(a)(2) excludes only "compensation" for loss and does not exclude punitive damages and statutory penalties imposed for willful violations of law. We have noted (Pet. Br. 28) that this conclusion draws support from the fundamental principle that exclusions from income are to be strictly construed.

1. a. Respondent asserts (Resp. Br. 36-39) that the question whether penalties and punitive damages awarded on account of malice or willfulness are within the scope of Section 104(a)(2) is not presented in this case because, in respondent's view, ADEA liquidated damages are compensatory as well as punitive. That contention is wrong for the reasons discussed at pages 4-10, *supra*.[12] Liquidated damages under the ADEA are

[12] Respondent errs in contending (Resp. Br. 37-38) that *Commissioner* v. *Miller*, 914 F.2d 586 (4th Cir. 1990), endorsed the view that ADEA liquidated damages are partly compensatory. That case did not even involve the ADEA. Moreover, the comments of the *Miller* court about liquidated damages under the pre-1947 FLSA decisions are inapposite for the reasons we have noted. See Pet. Br. 26 n.17.

identical in character to other types of punitive damages and statutory penalties—such as trebled damages under the antitrust laws—that are unquestionably subject to tax. See *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955). Indeed, as this Court has noted, ADEA liquidated damages are specifically described in the statute's legislative history as a "double damage" remedy for "willful violations" of the Act. *Trans World Airlines, Inc.* v. *Thurston*, 469 U.S. at 125; see page 7, *supra*.

b. Respondent correctly notes (Resp. Br. 39) that the Service has, over time, expressed differing views concerning the excludability of punitive damages under Section 104(a)(2). See Rev. Rul. 85-98, 1985-2 C.B. 51; Rev. Rul. 84-108, 1984-2 C.B. 32; Rev. Rul. 75-45, 1975-1 C.B. 47. As we state in our opening brief, however, during the period prior to 1975 and consistently since 1984 the Service has concluded that punitive damages do not represent an award "on account of personal injuries" within the scope of the statute. See Pet. Br. 27 n.18. It is well settled that "the Commissioner may change an earlier interpretation of the law" (*Dickman* v. *Commissioner*, 465 U.S. 330, 343 (1984)) and thereby "correct mistakes of law in the application of the tax laws to particular transactions" (*Dixon* v. *United States*, 381 U.S. 68, 72 (1965)). Courts are to look to the current, formal view of the Commissioner in deter-

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Respondent similarly errs in describing (Resp. Br. 38) the holding of *Reese* v. *United States*, 24 F.3d 228 (Fed. Cir. 1994). In *Reese*, the court noted that *Pistillo* v. *Commissioner*, *supra*, and *Redfield* v. *Insurance Company of North America*, *supra*, differed from *Reese* because those decisions involved only backpay. 24 F.3d at 234. The suggestion that backpay is "compensatory" is plainly not an endorsement of the proposition that liquidated damages for "willful violations" of the Act are "compensatory." See *ibid.*

mining the meaning of the agency's regulations. See *Commissioner* v. *Miller*, 914 F.2d 586, 591 (4th Cir. 1990); Morrison, *Getting a Rule Right and Writing a Wrong Rule: The IRS Demands a Return on All Punitive Damages*, 17 Conn. L. Rev. 39 (1984). "[A] revised interpretation deserves deference" if it reflects a "reasoned analysis" of the regulation. See *Rust* v. *Sullivan*, 500 U.S. 173, 186-187 (1991), citing, *e.g.*, *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837, 862 (1984).

The Commissioner's view of the statute and regulation reflects a "reasoned analysis." See Pet. Br. 25-35. Respondent errs in asserting (Resp. Br. 39) that the "plain language of Section 104(a)(2)" requires a different conclusion. Respondent claims that punitive and liquidated damages are within the scope of the statutory phrase "any damages" and are therefore excluded from income. The flaw in respondent's position is manifest; it seeks to isolate the term "any damages" from the subsequent term "on account of personal injuries." This Court has emphasized, however, that it does not "construe statutory phrases in isolation; we read statutes as a whole." *United States* v. *Morton*, 467 U.S. 822, 828 (1984).

As the court of appeals explained in *Reese* v. *United States*, 24 F.3d 228, 230 (Fed. Cir. 1994), "the language 'on account of' is not free of ambiguity; rather, it is susceptible of at least two conflicting interpretations." As we show in our opening brief (Pet. Br. 28-32), the structure, title and history of Section 104(a)(2) reflect that the statute is designed to permit tax-free recovery of "compensation" for injuries, not to permit tax-free recoveries of windfall, punitive damage awards.

Moreover, the dictionary definition of the term "on account of," on which respondent seeks to rely (Resp. Br.

37), is consistent with, and indeed supports, the Commissioner's interpretation. The definition of that phrase to mean "because of; for the sake of" (*ibid.*) comports with the Commissioner's view, for damages that are awarded to punish and deter willful misconduct are naturally referred to as received "because of" purposeful misconduct and "for the sake of" punishment and deterrence and not as the result of the personal injuries themselves. See *Reese* v. *United States*, 28 Fed. Cl. 702, 705 (1993), aff'd, 24 F.3d 228 (Fed. Cir. 1994).[13]

2. Respondent erroneously contends (Resp. Br. 40) that the decision in favor of the government in *Burke* supports the exclusion of punitive damages under Section 104(a)(2). As the Federal Circuit correctly noted in *Reese* v. *United States*, 24 F.3d 228, 234 (1994), Burke "did not present facts requiring the Court to determine whether punitive damages awarded in a personal injury action are received 'on account of' personal injury so as to be excludable from gross income by virtue of section 104(a)(2)." Accord, *Hawkins* v. *United States*, 30 F.3d 1077, 1081 (9th Cir. 1994), petition for cert. pending, No. 94-1041. The Court in *Burke* did not mention, let alone

[13] Respondent's critique (Resp. Br. 21-24) of the "return of capital" analysis is misconceived. The "return of capital" phrase accurately describes the fact that the 1919 Congress intended the original version of the statute to apply only to damages that compensate for personal injuries. See Pet. Br. 30-32. This point is confirmed by the structure of the original statute (Section 213(b)(6) of the Revenue Act of 1918, ch. 18, 40 Stat. 1066), which provided that gross income did not include:

> Amounts received through accident or health insurance or under workmen's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness.

disapprove of, the Service's position in Rev. Rul. 84-108 that punitive damages are not excludable under the original version of Section 104(a)(2).[14]

Respondent's further suggestion (Resp. Br. 17) that the 1989 amendment to Section 104(a)(2) "changed" the law with respect to the excludability of punitive damages is also wrong. This Court long ago rejected the argument that an amendment to the tax laws provides evidence that the law was formerly otherwise. *Higgins* v. *Smith*, 308 U.S. 473, 479-480 (1940). That principle applies with particular force in this case, for neither the text of the 1989 amendment nor its history contains any suggestion that Congress (either in 1989 or in 1919) believed punitive damages were properly excluded from income under the original statute. Despite respondent's assertion (Resp. Br. 41) that it "would have made no sense" for Congress to leave unsettled the tax treatment of punitive damages received in physical injury cases, the legislative history establishes that that is exactly what Congress did. As noted in our opening brief (Pet. Br. 33 n.22), the Conference Committee redacted language from another version of the bill that had affirmatively provided for the exclusion of punitive damages received in physical injury cases and substituted the "double negative" phraseology contained in the 1989 amendment. See Kahn, *supra*, 2 Fla. Tax. Rev. at 366-371.[15] The 1989 amendment precludes application

[14] "The Court's reference to punitive damages [in *Burke*] was merely part of a broad definition of tort liability rather than a holding that punitive damages were 'compensation for injuries or sickness,' excludable from income under section 104(a)(2)." *Reese* v. *United States*, 24 F.3d at 234. Accord, *Hawkins* v. *United States*, 30 F.3d at 1081.

[15] The redacted language provided that the Section 104(a)(2) exclusion "shall not apply to any punitive damages *unless such*

of the Section 104(a)(2) exclusion to punitive damages recovered in nonphysical injury cases but is silent as to the taxation of punitive damages received in physical injury cases.

Respondent acknowledges that the statement in *Burke* suggesting that the 1989 amendment "allow[s]" the exclusion of punitive damages in post-amendment physical injury cases is "dictum" (Resp. Br. 5). Moreover, that statement is inconsistent with the history of the 1989 amendment and contravenes the fundamental principle of statutory construction that "[e]xemptions from taxation do not rest upon implication," *United States Trust Co.* v. *Helvering*, 307 U.S. 57, 60 (1939). As Professor Kahn observes:

> Congress did not inadvertently omit to make an explicit statement that punitive damages connected with a physical injury are excluded. To the contrary, the draft containing that statement was altered to avoid taking a position on that issue. It is clear then that the 1989 amendment has no bearing on the excludability of punitive damages in cases involving physical injury.

Kahn, *supra*, 2 Fla. Tax. Rev. at 370.

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damages are in connection with a case involving physical injury or physical sickness" (emphasis added). See Kahn, *supra*, 2 Fla. Tax Rev. at 370.

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For the foregoing reasons and the reasons stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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